

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:RFP:MIA:POST166638-01
TSMoraviaIsrael

date: JUL 29 2002

to: Paul Goldman, International Examiner, through Mirtha Pujol,
International Manager

from: Associate Area Counsel (LMSB) Miami, Florida

subject: [REDACTED] Inc.
[REDACTED]
[REDACTED]

Form 5471 Filing Requirements

This memorandum responds to your request for assistance.
This memorandum should not be cited as precedent.

This issue was not coordinated with Industry Counsel. Prior contact was made with Jeffrey X. Johnson from the National Office.

ISSUE

1. Whether Taxpayer is required to file Forms 5471 pursuant to I.R.C. § 6038(a).

2. If Taxpayer is required to file Forms 5471 pursuant to I.R.C. § 6038(a) and does not file said forms, whether Taxpayer's father can be held responsible for said filings and the penalties thereunder.

FACTS

[REDACTED], (hereinafter referred to as "Taxpayer"),
[REDACTED], (hereinafter referred to as "Taxpayer's father"),
and [REDACTED], Inc., (hereinafter referred to as "[REDACTED]") are all under examination for the [REDACTED] and [REDACTED] taxable years. Taxpayer and Taxpayer's father, each respectively file a joint Form 1040, U.S. Individual Income Tax Return with their wives for the years at issue. [REDACTED] is a domestic corporation belonging to Taxpayer's father which concentrates on [REDACTED]

_____.¹ In _____, _____ was a S corporation and in _____, _____ switched to a C corporation.

Taxpayer and each of his _____ siblings, respectively, own _____% of _____ (hereinafter referred to as "_____"). _____ is incorporated in _____. There are _____ tiers of foreign corporations (a total of _____ companies, none of whom have filed check the box forms) below _____; _____ owns these foreign corporations in percentages ranging from _____% at the lowest and _____% at the highest.² _____, and _____ entities under _____, qualify as Category 5 filers, as they are all CFCs.³ Taxpayer failed to file Forms 5471 for _____ and the _____ entities under _____ for the taxable years _____ and _____. Further, there was no statement on Taxpayer's income tax return indicating that one of his siblings filed the 5471s required _____ and its subsidiaries. Taxpayer also failed to file _____'s Form 1120F, the U.S. Income Tax Return of a Foreign Corporation, for the taxable years _____ and _____.

Although the audit commenced more than _____ year ago, Taxpayer's representative only recently submitted a copy of a Form 5471 and Form 1120F for _____'s taxable year _____.⁴ The International Examiner has decided that penalties are applicable in this case.

¹ Taxpayer receives compensation and a car allowance from _____; supposedly, Taxpayer performs services for _____. Taxpayer's _____ siblings, either directly, or via their spouses, also receive some compensation/car allowance from _____. Many deductions are inappropriately taken on _____'s domestic income tax return.

² Please see attached as Exhibit A, Taxpayer's organizational chart including _____ and the _____ entities beneath it.

³ The International Examiner can set up additional penalties and require additional entities to file Forms 5471 if he can show that they are Category 2 filers. See instructions on Form 5471 for Category 2 filers, requiring officer or director status.

⁴ International Examiner requested said Forms via an Information Document request rather than the pattern letter issued to begin the running of the 90 day period under I.R.C. § 6038(b)(2) and Treas. Reg. § 1.6038-2(k)(1)(ii). Counsel has advised the International Examiner to issue said pattern letter to both Taxpayer and Taxpayer's father.

LAW AND ANALYSIS

1. **Whether Taxpayer is required to file Form 5471 pursuant to I.R.C. § 6038(a).**

I.R.C. § 6038 requires information reporting by a "United States person" that "controls" a foreign corporation. For this purpose, the term "United States person" generally has its normal meaning.⁵ "Control" means the ownership of stock having over 50% of the voting power or value of all the stock of the foreign corporation under I.R.C. §§ 6038(e)(1), 6038(e)(2), and Treas. Reg. § 1.6038-2(b).

Information reporting is also required under I.R.C. § 6038 if the foreign corporation is a controlled foreign corporation (hereinafter referred to as "CFC").⁶ Pursuant to the instructions for filing Form 5471, this type of filer is considered a Category 5 filer. Note also, that all stock owned by a foreign corporation shall be considered as being owned proportionately by its shareholders as per I.R.C. § 958(a)(2) and therefore additional Forms 5471 become necessary depending upon the circumstances.

A U.S. person subject to I.R.C. § 6038 must report information required by regulations⁷, including:

1. Name, business, place of business, and place of incorporation of the foreign corporation;
2. Foreign corporation's post-1986 undistributed earnings;
3. Balance sheet;
4. Profit and loss statement;
5. Information about transactions between the foreign corporation and certain related persons; and
6. Description of the outstanding classes of stock and the names of U.S. persons that own 5 percent or more of

⁵ I.R.C. § 6038(f)(2) refers to I.R.C. § 7701(a)(30).

⁶ See I.R.C. § 6038(a)(4). See also I.R.C. §§ 957 and 951 for CFC and U.S. shareholder rules, respectively.

⁷ See I.R.C. §§ 6038(a)(1)(A), 6038(a)(1)(B), 6038(a)(1)(C), 6038(a)(1)(D), and 6038(a)(1)(E) and Treas. Reg. §§ 1.6038-2(f)(9), 1.6038-2(g)(1), and 1.6038-2(g)(2).

the value of any class of stock.

Pursuant to I.R.C. § 6038(a)(2) and Treas. Reg. § 1.6038-2(a)⁸, a U.S. person reports information under I.R.C. § 6038 for the foreign corporation's annual accounting period ending with or within the U.S. person's taxable year. Form 5471 must be attached to the taxpayer's regular income tax return and filed by the due date (including extensions) as per Treas. Reg. § 1.6038-2(i).

I.R.C. § 6038 may require more than one person to report information about the same foreign corporation for the same period. In that case, the Treasury may allow one of the persons to file the information as per I.R.C. § 6038(d). For example, Treas. Reg. § 1.6038-2(j)(1) allows two or more taxpayers to make a joint information return, to be filed by one of the persons.

If a U.S. person fails to comply with I.R.C. § 6038, three types of penalties may apply. First, failure to comply may result in a criminal penalty under I.R.C. § 6038(f)(1) and Treas. Reg. § 1.6038-2(k)(4). Second, a civil penalty of \$10,000 may apply for a violation under I.R.C. § 6038(b)(1) and Treas. Reg. § 1.6038-2(k)(1)(i). If the Service notifies the taxpayer of a failure and the taxpayer still does not comply after ninety days, a penalty of \$10,000 applies for each thirty-day period during which the failure continues up to \$50,000 under I.R.C. § 6038(b)(2) and Treas. Reg. § 1.6038-2(k)(1)(ii); The total civil penalty may equal a total of \$60,000. Third, the taxpayer may suffer a reduction in allowable foreign tax credits as per I.R.C. § 6038(c) and Treas. Reg. § 1.6038-2(k)(2).

If a U.S. person fails to report information required by I.R.C. § 6038, the time for the Service to assess any tax with respect to any "event or period" to which such information relates will not expire before the date that is three years after the date on which the Service is furnished the required information as per I.R.C. § 6501(c)(8).

If a taxpayer has "reasonable cause" for a failure to comply with I.R.C. § 6038, the taxpayer may avoid or reduce the civil penalties and the reduction in foreign tax credits as per Treas. Reg. § 1.6038-2(k)(3)(i). Treas. Reg. § 1.6038-2(k)(3)(ii) requires that the taxpayer make an affirmative showing that

⁸ The regulations spell out other required information. See Treas. Reg. §§ 1.6038-2(f), 1.6038-2(g) and Prop. Treas. Reg. §§ 1.6038-2(e), 1.6038-2(f)(10)(v).

satisfies the Service; That is, the taxpayer bears the burden of affirmatively demonstrating reasonable cause, which necessitates taking into consideration all of the facts and circumstances of the case. Generally, reliance on the substantive advice of an informed, qualified professional is reasonable. In contrast, the taxpayer's reliance on a professional to carry out ministerial duties not requiring special expertise, such as timely filing a return, is not reasonable. U.S. v. Boyle, 469 U.S. 241 (1985).

In this case, Taxpayer is a United States person that controls [REDACTED] (a Category 5 filer) and is therefore subject to I.R.C. § 6038 and must file Form 5471. The [REDACTED] entities under [REDACTED]

[REDACTED], are also considered entities "controlled" by Taxpayer, as they are CFCs, and are therefore subject to I.R.C. § 6038 and must file Forms 5471. Taxpayer did not file the required Forms 5471 for [REDACTED] or for the [REDACTED] entities below [REDACTED].⁹ Taxpayer is considered as owning his proportionate share of the stock owned by [REDACTED] as per I.R.C. § 958(a)(2), and therefore, these additional Forms 5471 are required. The penalties are appropriately asserted.

Finally, Taxpayer has not demonstrated reasonable cause for its failure to file the Forms 5471. First, it is likely that the filing of the Form 5471 is a ministerial act for which the taxpayers cannot be excused of responsibility. Second, even if the filing of a Form 5471 is not a ministerial act and the taxpayer could theoretically rely on a professional, Taxpayer has not shown reliance on an informed, qualified professional.

2. If Taxpayer is required to file Form 5471 pursuant to I.R.C. § 6038(a) and does not file said form, whether Taxpayer's father can be held responsible for said filing, the lack of said filing, and the penalties thereunder.

As discussed above, I.R.C. § 6038 requires information reporting by a United States person that controls a foreign corporation. In measuring ownership for this purpose, the

⁹ Note that Taxpayer claims that some of the entities below [REDACTED] are dormant and therefore, are not required to file Form 5471. This is incorrect as I.R.C. § 6038 also applies to dormant foreign corporations. See Rev. Proc. 92-70, 1992-2 CB 435 for the Service's summary procedure for filing with respect to dormant foreign corporations.

attribution rules of I.R.C. § 318 apply with two modifications: First, there is no attribution from a foreign person to a U.S. person under the "to-entity" attribution rules under I.R.C. § 6038(e)(1)(A).¹⁰ Second, "from-entity" attribution is allowed from a corporation to its 10% or more shareholders (not just to a 50% or more shareholder) under I.R.C. § 6038(e)(1)(B) and Treas. Reg. § 1.6038-2(c)(3).

Normally, Taxpayer's father would be exempt from filing Forms 5471 for [REDACTED] and its subsidiaries, however, Treas. Reg. § 1.6038-2(j)(2)(i) only exempts a taxpayer that owns no direct interest in a foreign corporation if the direct owner of stock attributed to the taxpayer complies with I.R.C. § 6038. In this case, there was no such compliance. As indicated above, neither Taxpayer nor his siblings (who own the remaining [REDACTED]%) filed Forms 5471 for [REDACTED] and its subsidiaries.

Due to the rules of attribution under I.R.C. § 318, Taxpayer's father is responsible for timely filing Forms 5471 for [REDACTED] and its subsidiaries. Since the Forms were not filed, Taxpayer's father is responsible for the penalties. Taxpayer's father will also be responsible for the additional penalties in the case of non-compliance after 90 days of notification.

CONCLUSION

Based on the above discussion, it is the position of this office that the penalties for failing to file the required Forms 5471 under I.R.C. § 6038 are appropriately due and owing from either Taxpayer or Taxpayer's father. Furthermore, the Service is not precluded from requiring Taxpayer or Taxpayer's father to pay an additional penalty of \$10,000 for each of the [REDACTED] CFCs for each thirty-day period during which the failure continues, up to \$50,000 for each entity under I.R.C. § 6038(b)(2) and Treas. Reg. § 1.6038-2(k)(1)(ii).

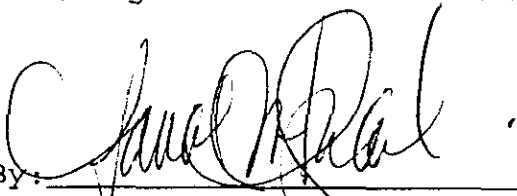
This advisory opinion is being sent to the National Office for a ten (10) day post-issuance review. If you have any questions regarding the foregoing, please contact Tamara Moravia-Israel at (305)982-5319.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney client privilege. If disclosure becomes necessary,

¹⁰ See also Treas. Reg. §§ 1.6038-2(c)(1) and 1.6038-2(c)(2).

please contact this office for our views.

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